MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS MIG 1 RATING TO THE CITY OF GLOUCESTER'S (MA) $6.3 MILLION G.O. BANS; Aa3 LONG-TERM RATING AFFIRMED AND NEGATIVE OUTLOOK REMOVED

Global Credit Research - 22 Jun 2011

Aa3 LONG-TERM RATING APPLIES TO $54.6 MILLION OUTSTANDING G.O. BONDS

Municipality
MA

Moody's Rating

ISSUE	RATING
General Obligation Bonds Anticipation Notes, Series 2011	MIG 1

Sale Amount	$6,300,000
Expected Sale Date	06/23/11
Rating Description	Bond Anticipation Notes

Moody's Outlook No Outlook

Opinion

NEW YORK, Jun 22, 2011 -- Moody's Investors Service has assigned a MIG 1 rating to the City of Gloucester's (MA) $6.3 million General Obligation Bond Anticipation Notes (dated June 30, 2011 and due September 16, 2011). Concurrently, Moody's has affirmed the city's Aa3 long-term general obligation rating and removed the negative outlook affecting roughly $54.6 million of outstanding long-term debt. The notes are secured by the city's general obligation limited tax pledge as debt service has not been excluded from the limits of Proposition 2 ½.

SUMMARY RATINGS RATIONALE

Assignment of the MIG 1 rating reflects the city's demonstrated access to capital markets and satisfactory long-term credit characteristics. Affirmation of the Aa3 rating reflects Gloucester's sizeable tax base with significant redevelopment potential, average resident income levels, manageable debt burden and an improving financial position, although ongoing pressure is expected through the medium term due to recessionary revenue weakness at the state and local levels. Removal of the negative outlook recognizes the increase in the city's available reserves as well as the adoption of formal financial policies and the resolution of deficits in enterprise funds.

Proceeds of the current note issue provide short-term, new money financing for school roof replacements, fire department equipment and station repair, paving projects and combined sewer overflow remediation.

STRENGTHS

-Favorably located, primarily residential tax base with regional fishing port

-Reasonable plan to comply with financial policies

-Conservative approach to budgeting for general fund operations and enterprises

CHALLENGES

-Declining state aid

-High cost of pension and OPEB liabilities

-Lack of margin under Proposition 2 ½

DETAILED CREDIT DISCUSSION

DEMONSTRATED MARKET ACCESS

Moody's expects the city will continue to enjoy favorable access to the capital markets given its history of competitive bids on previous borrowings. The city received four bids on its most recent note sale, dated September 27, 2010, three bids on its note sale, dated June 17, 2010 and five bids on its note sale dated September 18, 2009. All bids were received from major regional and national financial institutions. This history indicates the city's ability to refund the notes, if necessary, at their September, 2011 maturity.

IMPROVING GENERAL FUND AND ENTERPRISE PERFORMANCE

Gloucester's available reserve position has begun to stabilize, with significant improvement demonstrated in enterprise operations. After several years of general fund operating deficits since fiscal 2006, the city's available reserves (unreserved general fund and stabilization fund) dropped to $907,000 in fiscal 2009, a very slim 1.1% of general fund expenditures, down from $2.7 million, or a healthier 3.5% of expenditures, in fiscal 2005. Ongoing improvements in financial reporting, monitoring and expenditure management enhanced stability of fiscal 2010 operations despite significant reductions in state aid. The city's free cash position was negative for several years, incorporating Gloucester's slim general fund reserve position as well as accumulated deficits in enterprise, capital project and special revenue funds. However, a more conservative approach to utility rate structure, revenue budgeting and expenditure management has resulted in structurally balanced general fund operations in fiscal 2010 and positive enterprise performance without transfers from the general fund. Fiscal 2010 results indicate an increase in available reserves to $4.7 million, 5.4% of general fund revenues, which attains compliance with the city's policy to maintain reserves between 5% and 16% of budget.

Despite serious financial strain in recent years, no appropriations have been made from the city's stabilization fund, which totals $1.9 million after a net transfer of roughly $400,000 from free cash in fiscal 2011. Projections for fiscal 2011 operations remain conservative and indicate another year of positive operations and a small increase in available reserves. A small portion of the city's $970,000 overexpenditure for snow and ice will be covered through transfers from stabilization and surplus overlay funds; the remainder was absorbed by departmental transfers and federal reimbursements. The adoption of local option meals and room occupancy excise taxes is expected to generate up to $425,000 annually in additional revenue. The fiscal 2012 budget is balanced without appropriations from free cash or other reserves and incorporates both a net $244,000 loss of state aid revenue as well as a 2.5% expenditure increase. Up to 76 layoffs are proposed in both general government and school department budgets, although recent changes in the city's employee health care plan could reduce the layoffs by roughly 20 positions. The school department budget has been reduced to make up for the loss of $900,000 in ARRA funding received in fiscal 2010, however staff and expenditure reductions are expected to match declining student enrollment trends. An enterprise fund will be established for the city's skating rink and is expected to be self-supporting through user fees, including debt service expenses.

The city has adopted a formal policy governing reserve levels, which is expected to promote stability and strengthen management's commitment to restoring structural balance and prudent reserve levels, enhancing long-term credit strength. The current policy is under review by the city council and proposes a total unreserved general fund and stabilization fund position between 5% and 16% of general fund expenditures. The city has achieved compliance with the policy minimum well ahead of its initial five-year plan to boost reserves to approximately $4.6 million, roughly 5% of expenditures by fiscal 2015.

Moody's believes the city's actions to stabilize finances and promote long-term flexibility will improve its financial position the medium term, although tax base growth is unlikely to provide significant new revenue for several years. Property taxes represented nearly 63.7% of fiscal 2010 revenues and collections have held steady despite a rise in foreclosures, similar to most cities and towns in the region. The city does not plan to propose an operating override in the near term and is therefore likely to remain at the limit of levying capacity under Proposition 2 ½. Growth in state aid revenue, which represented 22.2% of revenues in fiscal 2010, is also expected to remain flat through the medium term. Significant fixed costs, particularly related to employee salaries and benefits, will hinder the city's ability to substantially augment reserves in the medium term. Failure to grow reserve balances, at least in step with budgetary increases, will diminish long-term credit strength.

SIZEABLE COASTAL TAX BASE WITH REGIONAL FISHING PORT

Although Gloucester's $5.2 billion tax base is expected to experience additional contraction in fiscal 2012, the city remains well-positioned for long-term growth potential given its favorable location on Cape Ann and significant redevelopment opportunities. Located on the coast approximately 30 miles northeast of Boston (G.O. rated Aaa/stable outlook), the city's mostly residential tax base grew at a strong average rate of 15.2% annually between 2001 and 2007, although recent market value declines have slowed the pace of annual growth to 3.1% for the period between 2005 and 2011. Redevelopment activity continues, although revenue associated with new development totaled only $697,000 in fiscal 2010, significantly lower than the $803,100 annual average since 2000. Assessed valuation has dropped for four successive years, primarily reflecting weak national housing market trends, and the $5.2 billion fiscal 2012 valuation, representing values as of January 1, 2011, is less than the city's fiscal 2006 valuation of $5.5 billion. The city's local economy has traditionally been dominated by the seafood industry, but has recently diversified and now includes light manufacturing and high-tech employers. The first phase of the Gloucester Crossing retail development opened in 2010 and has added roughly 190,000 square feet of retail space and approximately $50 million in taxable value, increasing the city's commercial/industrial sector by nearly 10%. Other development projects remain in various permitting stages, but major developments, which may include a new hotel in the waterfront district and other residential and mixed-use projects, have not yet broken ground. Officials have completed a master plan for redevelopment of the city's harbor, which is expected to attract higher-end development, although this initiative hinges on the rezoning of some parcels. To capitalize on the city's historical significance, a privately-owned cruise ship terminal opened in 2007 and is expected to host 23 cruise stops in 2011, boosting local tourism activity. Resident wealth levels approximate commonwealth medians, and equalized value per capita is a strong $195,868, reflecting both a seasonal second-home community and a growing commercial/industrial presence.

AFFORDABLE DEBT BURDEN

Gloucester's overall debt burden (1.7% of equalized valuation) will remain manageable given above average amortization of principal (84.1% within 10 years), as well as efforts to prioritize future borrowing through its updated capital improvement plan. Debt service accounted for a reasonable 6.7% of expenditures in fiscal 2010 and incorporated 25% general fund support of sewer debt. The city's debt burden is somewhat mitigated by 67% commonwealth reimbursement of a portion of outstanding school construction debt. At present, management is updating its capital plan, which will include significant infrastructure improvements to bring water, wastewater and sewer operations in line with environmental standards. The city's voters may be asked to consider a debt exclusion vote to finance future major capital projects, which include the replacement or renovation of five elementary schools, all of which may qualify for partial support from the commonwealth. Gloucester has neither variable rate obligations nor exposure to derivative products.

WHAT COULD MAKE THE RATING GO UP?

- Significant improvement in available reserves

--Substantial tax base growth and diversification

-Improved demographic profile

WHAT COULD MAKE THE RATING GO DOWN?

- Failure to adhere to adopted financial policies

- Inability to maintain structural balance and grow reserves, at a minimum, in step with budget growth

- Increased debt burden

KEY STATISTICS

2008 population: 30,243 (-0.1% since 2000 census)

2011 Equalized Valuation: $5.9 billion

Average annual Equalized Valuation growth (2005-2011): 3.1%

2011 Equalized Value per capita: $195,868

Per Capita Income: $25,595 (98.6% of MA, 118.6% of US)

Median Family Income: $58,459 (94.8% of MA, 116.8% of US)

Unemployment (April, 2011): 8.8% (MA 7.4%, US 8.7%)

FY09 Undesignated general fund balance: $-616,000 (-0.7% of general fund revenues)

FY09 Available reserves: $907,000 (1.1% of general fund revenues)

FY10 Undesignated general fund balance: $3.2 (3.7% of general fund revenues)

FY10 Available reserves: $4.7 million (5.4% of general fund revenues)

Overall debt burden: 1.7%

Amortization of principal (10 years): 84.1%

Long-term general obligation debt outstanding: $54.6 million

The principal methodology used in this rating was Bond Anticipation Notes and Other Short-Term Capital Financings published in May 2007.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, parties not involved in the ratings, public information, confidential and proprietary Moody's Investors Service information, and confidential and proprietary Moody's Analytics information.

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